VZCZCXRO0808
RR RUEHCN RUEHGH RUEHVC
DE RUEHHK #2127/01 2271047
ZNY CCCCC ZZH
R 151047Z AUG 07
FM AMCONSUL HONG KONG
TO RUEATRS/DEPT OF TREASURY WASHDC
RUEHC/SECSTATE WASHDC 2602
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEHTA/AMEMBASSY ALMATY 0022
RUEHKB/AMEMBASSY BAKU 0001
RUEHEK/AMEMBASSY BISHKEK 0015
RUEHMO/AMEMBASSY MOSCOW 0435
RUEHNT/AMEMBASSY TASHKENT 0017
RUEHUM/AMEMBASSY ULAANBAATAR 1193
RHEHAAA/WHITE HOUSE WASHDC
RUEHIN/AIT TAIPEI 4633

C O N F I D E N T I A L SECTION 01 OF 02 HONG KONG 002127

SIPDIS

SENSITIVE
SIPDIS

STATE FOR EAP/CM NICODEMUS AND EEB/OMA MOORE, TREASURY FOR
HARSAAGER, WINTON, YANG, NSC FOR DENNIS WILDER

E.O. 12958: DECL: 08/15/2017
TAGS: ECON EFIN CH HK
SUBJECT: HONG KONG ECONOMISTS: CHINA'S SOVEREIGN WEALTH
FUND MORE RISK THAN REWARD

REF: HONG KONG 1931

Classified By: EP Acting Chief Jeff Zaiser. Reason 1.4 b

¶1. (SBU) Summary: Hong Kong-based economists believe China,s recently announced Sovereign Wealth Fund will face significant difficulties and is unlikely to achieve positive returns in the near term. Although details of how the fund will be managed have yet to emerge, analysts expect the fund will focus on purchases of natural resources and non-controlling strategic investments in "safer" large corporations. Portions of the fund could be divided among several Chinese equity managers as a means of bolstering domestic financial services expertise. End Summary.

¶2. (SBU) Comment: Hong Kong-based analysts were not overly concerned about the affect of this new fund on equity markets, noting that all sovereign wealth funds combined constitute less than 5% of global market capitalization. Local observers agree that the fund will have to operate on market-based principles or risk driving returns into the ground. Suggestions that sovereign wealth funds need to be more transparent are met with skepticism by analysts here, as is the suggestion that the IMF should have a role in writing global rules for such funds. Ten years after the Asia Financial Crisis, the IMF still has limited credibility among Asian economists. Interlocutors were more receptive to discussions about improving government fund governance and global best practices. End comment.

===
Markets, Manpower are Obstacles to Profits
===

¶3. (C) In separate meetings, Hong Kong-based economists, Peng Wensheng (protect), Head of the External Department, Hong Kong Monetary Authority, and Dr. Qiao Liu (protect), Assistant Professor of Finance at the University of Hong Kong, said the Chinese desire to seek higher returns on a portion of their enormous reserves was understandable, but that the proposed sovereign wealth fund is being established at a difficult time. A new fund entering the market while stocks are trading at historically high levels (despite the slide in share prices in recent days) will find it difficult to be profitable. Qiu agreed, adding that political pressure

from government ministries and agency problems inherent in managing a government-controlled fund will make it difficult to implement a sound investment strategy.

¶4. (C) Other Hong Kong-based economists agreed that a large portion of the new Sovereign Wealth Fund would need to be managed by professionals. Dong Tao (protect), Managing Director of Non-Japan Asia Economics at Credit Suisse, argued that the Chinese financial agencies lack the manpower and skills to effectively manage such a large fund. Jim Walker (protect), Chief Economist at CLSA, agreed and suggested that Chinese authorities are likely to contract out management of a portion of the fund to several private Chinese fund managers as a means to deepen the skills of Chinese financial services providers.

==
Liquidity Expected to Limit Fund Options
==

¶5. (C) Peng and Tao noted that market liquidity could also pose a serious problem for fund managers. With such a large fund to invest, it will be difficult to purchase shares on the secondary market without significantly affecting equity prices. Tao predicted that the fund will end up taking small stakes in large-cap companies but will not engage in active trading or attempt to exert any influence on company management. The Chinese government is not establishing this fund to pursue political objectives, said Tao, they are merely seeking higher returns than are available with their current portfolio. Even so, in the short-term the government would be willing to lose money. Calls for increased transparency are likely to go unheeded, he said, as long as

confidentiality is expected to increase profitability in the

SIPDIS
long-term.

¶6. (C) While a portion of the fund could be directed to Chinese fund managers to purchase large blocks of stock, Walker and Tong expected that a significant portion would be used to purchase strategic natural resources. Tong noted that U.S. public reaction to the Chinese National Offshore Oil Corporation,s (CNOOC) Unocal bid discouraged Chinese companies from considering purchasing U.S. firms; he expected Chinese firms would now focus on buying up the underlying assets instead. Walker predicted that China,s increasing appetite for natural resources held the potential to lead to tensions with Russian interests in Central Asia.
Marut